

SCHWARTZ & BALLEEN
1990 M STREET, N.W. · SUITE 500
WASHINGTON, DC 20036-3418

(202) 776-0700

FACSIMILE
(202) 776-0720

M E M O R A N D U M

January 14, 2002

To Our Clients And Friends

Re: Notice of Proposed Rulemaking Implementing USA Patriot Act:
Requirement of Brokers or Dealers in Securities To Report Suspicious Transactions

SUMMARY

The USA Patriot Act requires the Treasury Department, after consultation with the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System, to publish proposed regulations requiring broker-dealers in securities to report suspicious transactions. The Financial Crimes Enforcement Network ("FinCEN") has issued this proposed rule to amend Bank Secrecy Act ("BSA") regulations to implement this requirement of the USA Patriot Act. Comments are due by March 1, 2002. Final regulations are to be issued by July 2, 2002.

While certain broker-dealers (e.g., broker-dealers that are affiliates or subsidiaries of banks or bank holding companies) have been required to report suspicious transactions for several years, the proposed rule will apply to all broker-dealers regardless of whether they are affiliates or subsidiaries of banks or bank holding companies.

REQUIREMENTS

Broker-dealers are to report suspicious transactions relating to a possible violation of Federal law or related to a money laundering violation or a violation of the Bank Secrecy Act.

SCHWARTZ & BALLEN

A transaction is to be reported if it involves or aggregates to at least \$5,000 and

- the broker dealer knows or suspects a Federal criminal violation has been committed or attempted against, or through the broker-dealer; or
- the broker-dealer knows, suspects or has reason to suspect that the transaction:
 - involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity;
 - is designed to evade the requirements of the Bank Secrecy Act; or,
 - appears to serve no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction.

Transactions do not have to involve currency to be reported, and brokers-dealers are encouraged to report suspicious transactions even when the rule does not explicitly require such reporting (e.g., the transaction involves less than \$5,000). However, such voluntary filings do not relieve a broker-dealer from complying with other reporting requirements of the Securities and Exchange Commission (“SEC”) or self-regulatory organizations (“SRO”).

FinCEN anticipates that suspicious transaction reporting by broker-dealers in securities will not be a mechanical process tied to threshold levels but will be a risk-based approach focusing on customer activity and relationships.

A suspicious transaction is reported by completing a Suspicious Activity Report – Brokers or Dealers in Securities (“SAR-BD”) within thirty days after a broker-dealer becomes aware of a suspicious transaction. The SAR-BD is to be filed with FinCEN, and the broker-dealer is to maintain separately any supporting documentation. However, situations requiring immediate attention, such as ongoing money laundering schemes, are also to be reported immediately to the appropriate law enforcement authorities and to the SEC.

The proposed rule creates two exceptions from these reporting requirements:

- lost, stolen, missing or counterfeit securities are to be reported to the SEC in accordance with existing rules and not on an SAR-BD
- violations of federal securities law (or rules of an appropriate SRO) by an employee or registered representative of a broker-dealer are to be reported under existing industry procedures and not on an SAR-BD.

A broker-dealer is prohibited from notifying anyone involved in a suspicious transaction that it has been reported. The SAR-BD or supporting documentation cannot be disclosed to

SCHWARTZ & BALLEN

anyone except where such disclosure is requested by FinCEN, the SEC, an SRO registered with the SEC or another appropriate law enforcement or regulatory agency.

The proposed rule reflects the recent amendment to the Bank Secrecy Act regulations by the USA Patriot Act that extends the safe harbor for suspicious transaction reporting to arbitration proceedings. A broker-dealer, and any director, officer, employee, or agent of such broker-dealer is not liable under any Federal or state law or regulation or under other legally enforceable agreement including arbitration, for a disclosure made in filing a suspicious transaction report or for failing to disclose that such a report has been filed.

Failure to report a suspicious transaction as required by the rule may constitute a violation of the BSA or BSA regulations.

DEFINITIONS

The term “broker-dealer in securities” has the meaning assigned to it by BSA regulations. However, insurance companies or their affiliates that are registered broker-dealers simply to permit the sale of variable annuities are subject to these suspicious transaction reporting rules even though they are currently exempted from BSA reporting requirements.

The term “transaction” has the same meaning as that in the BSA regulations relating to suspicious transaction reporting except it is being broadened to include transactions involving any instrument that falls with the definition of “security “ in the Securities Exchange Act of 1934.

A copy of the proposed rule can be found at <http://www.schwartzandballen.com/WhatsNew.htm>.

If you have any questions concerning FinCEN’s proposed rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.